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No.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

ALFA-LAVAL FOOD & DAIRY CO., and ALFA-LAVAL CREDIT AB,

Petitioners,

v.

BRITZ, INC., HELM CONCENTRATES, INC., and HELM TOMATOES, INC.,

Respondents.

On Petition For Writ Of Certiorari To The Supreme Court Of California

APPENDIX TO THE PETITION FOR WRIT OF CERTIORARI

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10

INDEX TO APPENDIX

	App. Page
Decision of the Court of Appeal of California	1
Order of the Supreme Court of California	29
Britz's Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration ..	30
Alfa-Laval's Reply to Memorandum in Opposition to Petition to Compel Arbitration	43
Letter from Rocco M. Scanza of the AAA to Messrs. White, Dockterman, Kaplan and Frame dated August 4, 1992 denying Britz's request to disqualify the arbitrator	56
Letter from Rocco M. Scanza of the AAA to Messrs. White, Dockterman, Kaplan, Frame, Vorzimer, Cotkin and Dolinsky dated February 18, 1993 reaffirming the arbitrator	58
Order of the Superior Court confirming arbitration award	60
Judgment of the Superior Court	63
Modification Order of Court of Appeal of California	65

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BRITZ, INC. et al., Plaintiffs and Appellants,

v.

ALFA-LAVAL FOOD & DAIRY CO. et al., Defendants and Respondents.

No. F020306.

Court of Appeal, Fifth District.

May 8, 1995.

* * * * *

OPINION

VARTABEDIAN, Associate Justice.

This is an appeal from a judgment confirming an arbitration award. Appellants primarily contend that arbitration should not have been compelled in the first instance and that the arbitrator failed to disclose certain conflicts of interest. We reverse the judgment and remand the matter to superior court for further proceedings consistent with this opinion.

FACTS AND PROCEDURAL HISTORY

The Underlying Controversy.

The merits of the underlying controversy are not before us in this appeal. (*Moncharsh v. Heily & Blase* (1992) 3 Cal.4th 1, 11, 10 Cal.Rptr.2d 183, 832 P.2d 899.) Accordingly, we only briefly summarize the rather complex facts.

Appellants are interrelated corporations that, in various combinations, contracted with respondents to buy and lease certain machines and equipment essential to the operation of a tomato paste processing plant. The total sale/lease price exceeded $1.5 million.

The plant never reached its production goals and appellants closed the plant during its first season of operation. They sold the plant at a substantial loss. They then sued respondents in Fresno County Superior Court for more than $10 million in compensatory and exemplary damages.

The Arbitration.

The sales and lease contracts contained arbitration clauses. Respondents moved in the superior court for an order staying appellants' lawsuit and compelling arbitration of the dispute. Appellants contested this motion. The motion was granted.

The arbitration was to be conducted through the American Arbitration Association (AAA). Pursuant to a list of potential arbitrators submited by AAA, the parties agreed to the appointment of a single arbitrator, John Peterson, a Fresno attorney.

The arbitration was bifurcated. The liability portion began on January 6, 1992. The arbitrator issued an interim award in favor of respondents on May 22, 1992. He issued a final award in favor of respondents in the amount of $587,425, plus costs and attorney fees in an unspecified amount, on March 31, 1993. The award was served by mail on the parties on April 6, 1993. After additional submissions by the parties, the arbitrator on May 6, 1993, issued a supplemental award of $1,412,953.75 for respondents' attorney fees and $696,747.45 as costs.

The Controversy About the Arbitrator's Neutrality.

Respondents were represented in the initial superior court proceedings by McCormick, Barstow, Sheppard, Wayte & Carruth, a Fresno law firm (McCormick). Attached to their petition to compel arbitration was a copy

of a demand for arbitration filed with AAA. That document named as respondents' attorneys Craig M. White and Michael Dockterman of Chicago, Illinois. White and Dockterman are with the Chicago law firm of Wildman, Harrold, Allen & Dixon (Wildman). With one important exception, the Wildman firm, not McCormick, appeared for respondents in the arbitration. When the matter returned to superior court after the arbitration, both McCormick and Wildman appeared for respondents.

After Peterson issued his interim award in favor of respondents, appellants requested that Peterson disclose all past and present relationships with the McCormick firm. Eventually, Peterson did so. The relationships included a number of referrals of legal business to Peterson and his firm from McCormick in the ordinary course of business. These did not involve any financial relationship between the two firms.

Peterson also disclosed that in 1984 he had been retained by McCormick as an expert witness in a legal malpractice case McCormick was defending on behalf of another Fresno law firm. In addition, Peterson disclosed that in November of 1991 and December of 1991 he had been retained by McCormick as an expert witness in two other legal malpractice cases in which McCormick represented law firm defendants. He was still involved in the 1991 cases at the time of the disclosure.

In November 1991, attorneys from McCormick tried to have a subpoena issued by the superior court for the production of documents by a third party involved in construction of appellants' tomato processing plant. The superior court declined to issue the subpoena; it instructed respondents to seek the subpoena from the arbitrator. This gave rise, on December 2, 1991, to the only appearance in the arbitration by a McCormick attorney.

On that date, attorney John T. Savrnoch of McCormick mailed to Peterson a three-page letter on McCormick letterhead. The letter referenced the pending arbitration and requested issuance of a subpoena on behalf of respondents, explaining in detail the importance of the requested materials to respondents' arbitration presentation. The letter included the following statement: "By this letter, the attorneys for Alfa-Laval respectfully request that a records only deposition subpoena be served upon L & A Engineering, Inc. for the following documents. . . ." Peterson granted the request for subpoena by means of a letter from Peterson to McCormick, with joint addressees Wildman, appellants' attorney, and the attorney for L & A Engineering.[1]

Peterson disclosed his role as an expert witness for McCormick on July 9, 1992, and, in greater detail, on July 15, 1992. Based on this relationship and the referrals of cases to Peterson and his firm by McCormick, appellants requested appointment of a new arbitrator by letter to AAA dated July 21, 1992. AAA, after soliciting input from respondents and Peterson, declined on August 4, 1992, to disqualify Peterson. The AAA decision did not contain a statement of reasons.

Appellants sought relief in their superior court and by petition for extraordinary writ in this court. All of appellants' efforts were unsuccessful.

Peterson presided over the damages portion of the arbitration beginning February 22, 1993.

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[1] Appellants' motion to augment record on appeal, filed July 19, 1994, is denied. Appellants' request for judicial notice (Mar. 24, 1995) and respondents' motion to augment record on appeal (Mar. 28, 1995) are granted.

Postarbitration Proceedings in Superior Court.

Appellants renewed their petition to vacate the arbitrator's award on April 21, 1993, noticing a hearing for May 28, 1993, in superior court. They alleged Peterson's various connections with McCormick created a reasonable impression of possible bias on Peterson's part. Respondents petitioned to affirm the award. Both parties submitted declarations of various attorneys. The parties also relied on Peterson's letter of July 9, 1992, in which he states:

> "In the past, when I have arbitrated a matter involving a party represented by the McCormick, Barstow firm, I have advised the American Arbitration Association that I have been on McCormick, Barstow's referral list. I would have done so in this case had I believed that McCormick, Barstow represented Alfa-Laval in the arbitration, or in any other capacity.
>
> ". . . I knew in April 1991 that McCormick, Barstow had represented Alfa-Laval in the Superior Court action. To the best of my knowledge then, and since then, McCormick, Barstow was not to be, and was not, involved in the arbitration."

The trial court conducted a law and motion hearing on the petitions to vacate and to confirm the award. The court determined that AAA's disposition of appellants' request for Peterson's disqualification was subject to only the limited judicial review available for factual and legal determinations of the arbitrator. In accordance with that standard, the court determined AAA's resolution of the conflict issue was a "plausible interpretation of the law and facts and was rendered with a minimum standard of fair dealing." Secondarily, the court concluded that appellants and their attorney had sufficient information before Peterson was selected as arbitrator about Peterson's relationship with McCormick to place upon appellants a duty of inquiry concerning these relationships; by failing to in-

quire in a timely manner, appellants waived objection to both types of relationships, the business referrals and the expert witness employment.

The court dismissed appellants' petition to vacate the arbitrator's award and granted respondent's petition to confirm the award, including attorneys fees and costs, with interest from the date of the award through entry of judgment. Judgment was entered on July 16, 1993. The total judgment was for $2,732,477.51, plus costs of the superior court proceedings.

Appellants filed a timely notice of appeal on September 14, 1993.

DISCUSSION

The parties impliedly agree that this case is governed by the Federal Arbitration Act (9 U.S.C. § 1 et seq.) (the Act). (See 9 U.S.C. § 2 [the Act covers arbitration arising from a "written provision in . . . a contract evidencing a transaction involving (interstate) commerce. . . ."].) "Generally, under the Act, arbitration is strongly favored, and 'any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration. . . .' [Citations.]" (*Rice v. Dean Witter Reynolds, Inc.* (1991) 235 Cal.App.3d 1016, 1023, 1 Cal.Rptr.2d 265.)

The Act, however, provides that an arbitration clause is not enforceable if "grounds as exist at law or in equity for the revocation of any contract" permit relief from the arbitration clause. (9 U.S.C. § 2; see Code Civ. Proc., § 1281.) We will turn first, therefore, to appellants' contention that such grounds exist and that the trial court impermissibly compelled arbitration of the present dispute. After concluding that arbitration was properly ordered,

we will address appellants' contention that the business relationships between Peterson and McCormick created a reasonable appearance of bias. We will conclude with a brief discussion of appellants' remaining points on appeal.

I. *Prearbitration Issues: Was the Order for Arbitration Proper?*

Appellants contend the trial court erred in ordering arbitration of their claims against respondents. Appellants argue they were entitled to judicial resolution of the disputes because the arbitration clauses in the contracts were void: "fraud permeated the entire contracts, including their arbitration provisions. The fraud was directed 'not only to the contracts as a whole, but to the agreements to arbitrate as well.' "

The fraud alleged by appellants is set forth in the complaint and in declarations by appellants' representatives who negotiated the contracts. These documents allege that critical representations made as to the performance and maintenance requirements of certain machines were false. They allege the representations were intended to induce, and did induce, appellants to enter into the contracts to buy and lease the machines. The complaint then states: "The false representations went not only to the contracts as a whole, but to the agreements to arbitrate, as well. Plaintiffs were led to believe by defendants that plaintiffs had to agree to arbitration as a *sine qua non* for acquisition of the equipment, bags and filling machines." Neither the complaint nor the declarations allege that this

latter representation by appellants, i.e., that there could be no contract without an arbitration clause, was false.[2]

It has long been established that fraud of the sort alleged by appellants does not prevent enforcement of an arbitration clause in a contract, even though the contract as a whole might be revocable due to the fraud. The seminal case is *Prima Paint v. Flood & Conklin* (1967) 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1270. In that case, defendant sold plaintiff a paint manufacturing business. Collateral to the sales contract, plaintiff entered into another contract retaining defendant as a business consultant. The consulting contract contained an arbitration clause. (388 U.S. at pp. 397-398, 87 S.Ct. at pp. 1802-1803.)

When a dispute arose under the contract, plaintiff sued in federal district court for rescission on the basis of fraud. Plaintiff contended defendant had falsely represented that it was not insolvent. (388 U.S. at p. 398, 87 S.Ct. at p. 1803.) Defendant petitioned the court to compel arbitration of the dispute. The federal district court granted the petition and the Court of Appeals affirmed. (*Id.* at pp. 399-400, 87 S.Ct. at pp. 1803-1804.)

The issue before the Supreme Court was whether under the Act the enforceability of the arbitration clause depended on the validity of the contract containing the arbi-

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[2] For the first time, in appellants' reply brief, there is the statement that appellants were "told that, to obtain the Alfa-Laval system and Alfa-Laval's expertise, it had to agree to arbitration. [Record cite to declarations.] Indeed, *these statements were as false* as Alfa-Laval's earlier statements that its equipment was highly reliable. . . ." (Emphasis added.) There is no record citation for this latter claim, and the citation to the opening brief is to a discussion of the representations about the machines, not about the necessity of agreeing to an arbitration clause.

tration clause, that is, whether the plaintiff was entitled to a judicial determination of its claim for rescission, or whether that was an issue for the arbitrator. (388 U.S. at p. 402, 87 S.Ct. at p. 1805.) The court concluded: "[I]f the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it. But the statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." (*Id.* at pp. 403-404, 87 S.Ct. at p. 1806, fn. omitted; see also *Moses H. Cone Hospital v. Mercury Const. Corp.* (1983) 460 U.S. 1, 22-23, fn. 27, 103 S.Ct. 927, 940-941, fn. 27, 74 L.Ed.2d 765; *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 Cal.3d 312, 322, 197 Cal.Rptr. 581, 673 P.2d 251 [adopting same standard under Code Civ.Proc. § 1208 et seq.].)

Appellants contend they have satisfied the requirement for judicial determination of their right to rescind the contracts: "The Federal Arbitration Act also requires that, in the face of allegations that fraud induced the arbitration agreement, the parties are entitled to have a jury decide whether a valid agreement to arbitrate exists." This contention is mistaken.

The allegations in the present case are the same as in *Prima Paint, supra*, 388 U.S. 395, 87 S.Ct. 1801, namely, that the contracts generally were a result of respondents' fraud. There is no allegation whatsoever that appellants were fraudulently induced to enter into the arbitration agreements in any way different from the way they were induced to pay money or make other agreements under the contracts. The only fraud alleged is as to the contracts generally.

The present case is wholly different from the cases appellants cite in which the issue of fraud was judicially determined. In some of those cases, the plaintiff did not know he or she was entering into a contract at all, or did not know it contained an arbitration clause. (See *Strotz v. Dean Witter Reynolds, Inc.* (1990) 223 Cal.App.3d 208, 217-218, 272 Cal.Rptr. 680 ["plaintiff has alleged that defendants deceived her as to the nature and effect of the documents"]; *Ford v. Shearson Lehman American Express, Inc.* (1986) 180 Cal.App.3d 1011, 1028-1029, 225 Cal. Rptr. 895; *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal.App.3d 19, 30, 32, 136 Cal.Rptr. 378; see also *Rice v. Dean Witter Reynolds, Inc., supra,* 235 Cal.App.3d at pp. 1024-1025, 1 Cal.Rptr.2d 265.[3]) In the other case appellants cite, *Green v. Mt. Diablo Hospital Dist.* (1989) 207 Cal.App.3d 63, 71, 254 Cal.Rptr. 689, plaintiff alleged the contract in question was illegal and that the pervasive illegality eviscerated the arbitration clause. (See *id.* at p. 73, 254 Cal.Rptr. 689.)

In the present case, there is no allegation appellants did not know what they were signing, that they signed under duress, or that the contracts were illegal. Instead, the allegations show that in order to secure a competitive advantage in the tomato paste industry, appellants agreed to buy and lease respondents' machines and to arbitrate disputes with respondents. Whether the purchase, lease and arbitration agreements were fraudulently induced was

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[3] One recent case, citing all of the foregoing cases in support of its conclusion, stated: "California cases are unanimous in holding that *Prima Paint* does not require arbitration where, as alleged here, the plaintiffs were so deceived they did not understand they were contracting." (*Lynch v. Cruttenden & Co.* (1993) 18 Cal.App. 4th 802, 811, 22 Cal.Rptr.2d 636.)

a question properly determined by arbitration. (*Lynch v. Cruttenden & Co., supra,* 18 Cal.App.4th at p. 810, 22 Cal.Rptr.2d 636.)

II. *Postarbitration Issues.*

A. *Waiver of the Arbitrator's Alleged Conflict of Interest.*

Appellants learned the full extent of Peterson's contact with McCormick after they lost the liability portion of the arbitration. At that time, appellants sought disqualification of Peterson and appointment of a new arbitrator. They sought this relief from the AAA, the trial court, this court (by writ petition) and, finally, by renewed petition in the trial court to vacate the final arbitration award. Appellants' requests were denied.

Appellants now raise the conflict of interest issue on this appeal. Respondents contend that, as the trial court found, appellants waived this issue when they initially accepted Peterson as the arbitrator without any inquiry concerning his contact with McCormick.

In some measure, we agree with respondents. It is clear from the undisputed evidence that one of appellants' officers (Glassman) and their attorney (Frame) both knew that Peterson's firm received business referrals from McCormick. There is nothing in Peterson's subsequent disclosures that indicates the more recent referrals were different in kind or frequency from the pattern of referrals of which appellants were generally aware. As to those matters, appellants selected Peterson as arbitrator without seeking further disclosure. This waived appellants' objection to Peterson based on his failure to disclose business referrals. (*Health Services Management Corp. v. Hughes* (7th Cir. 1992) 975 F.2d 1253, 1262-1263.)

When we turn to the expert witness relationship, however, we must agree with appellants that the trial court erred as a matter of law. No substantial evidence supports a finding that appellants waived this basis for Peterson's disqualification.

Common sense and experience tell us there is a vast difference between a relationship six years dormant, about which appellants knew, and a current and thriving relationship, about which appellants knew nothing prior to the arbitration. The relationship about which appellants knew was much the same as the relationship between the arbitrator and the party in *Merit Insurance Co. v. Leatherby Ins. Co.* (7th Cir. 1983) 714 F.2d 673. In that case, 14 years before the arbitration, the arbitrator had been a subordinate employee of the president of one of the parties to the arbitration, when both men had worked for a different insurance company. (*Id.* at p. 680.) The arbitrator failed to disclose that information. In rejecting a subsequent motion to vacate the arbitration award, the court concluded, "And when a former employee sits in judgment on a former employer there is no presumption that he will be biased in favor of the former employer; he may well be prejudiced against him." (*Ibid.*)

So, too, in the present case. Appellants may well have concluded that the isolated nature of Peterson's previous experience as a witness for McCormick may have left him slightly bitter about that firm, or at least devoid of positive feelings. He was, after all, never again asked to serve as an expert witness for McCormick, as far as appellants knew.

By contrast, the new engagements, coming just a few weeks before the commencement of the arbitration, established a current monetary connection between Peterson

and McCormick. Such a relationship, as a matter both of perception and of reality, is wholly different from the 1984 employment about which appellants had knowledge. We conclude the earlier service as an expert witness did not put appellants on notice there might be a current relationship with McCormick; appellants were entitled to rely on Peterson's duty to disclose. (See *Betz v. Pankow* (1993) 16 Cal.App.4th 931, 937, 20 Cal.Rptr.2d 841; compare *Betz v. Pankow* (1995) 31 Cal.App.4th 1503, 38 Cal.Rptr.2d 107 [duty *to investigate* for conflicts is narrower than duty *to disclose* known conflicts]; *San Luis Obispo Bay Properties, Inc. v. Pacific Gas & Elec. Co.* (1972) 28 Cal.App.3d 556, 569, 104 Cal.Rptr. 733 [same].)

As a practical matter, of course, appellants had no choice but to rely on Peterson for voluntary disclosure. Even if appellants had assumed the obligation to inquire about current employment by McCormick at the time of Peterson's appointment as arbitrator, Peterson would have answered truthfully that there was no such employment. The employment arose months later, in circumstances appellants could not reasonably have anticipated when they agreed to Peterson as the arbitrator.

The practical view of the matter—that the conflict information is usually known only to the arbitrator and the opposing party—has led to a consistent line of cases holding that the arbitrator has a duty to disclose potential conflicts of interest. (See *Commonwealth Corp. v. Casualty Co.* (1968) 393 U.S. 145, 149, 89 S.Ct. 337, 339, 21 L.Ed.2d 301;[4] *Kaiser Foundation Hospitals, Inc. v. Superior Court* (1993) 19 Cal.App.4th 513, 517, 23 Cal.Rptr. 2d 431; *Wheeler v. St. Joseph Hospital* (1976) 63 Cal.App.

[4] Also cited as *Commonwealth Coatings Corp. v. Continental Casualty Co.*

3d 345, 371, 133 Cal.Rptr. 775; *Johnston v. Security Ins. Co.* (1970) 6 Cal.App.3d 839, 842, 86 Cal.Rptr. 133.) While "the consequences of such a failure [to disclose] may be overcome if the pertinent facts are actually revealed, or otherwise become known, to the parties in some other fashion" (*Kaiser Foundation Hospitals, supra,* at p. 517, 23 Cal.Rptr.2d 431), the outdated and ambiguous information appellants possessed about Peterson's service as an expert witness did not adequately supplant the duty to disclose in this case. (See *ibid.*)

In summary, appellants knew the essence of one basis for objection to Peterson's qualifications as arbitrator, namely, the referral of cases between Peterson and McCormick in the ordinary course of business. Accordingly, that objection was waived by the failure to pursue it prior to Peterson's appointment as arbitrator. (*Health Services Management Corp. v. Hughes, supra,* 975 F.2d 1253 at pp. 1262-1263; see *Ray Wilson Co. v. Anaheim Memorial Hosp. Assn.* (1985) 166 Cal.App.3d 1081, 1089-1090, 213 Cal.Rptr. 62.) The objection based on Peterson's enlistment by McCormick as an expert witness in November and December of 1991, however, was not waived. (*Kaiser Foundation Hospitals v. Superior Court, supra,* 19 Cal. App.4th at p. 517, 23 Cal.Rptr.2d 431.) Our discussion of the ramifications of Peterson's relationship with McCormick will address only that latter relationship.

B. *The AAA Determination and the Standard of Judicial Review.*

Rule 19 of AAA Rules of Commercial Arbitration provides:

> "Disclosure and Challenge Procedure—Any person appointed as neutral arbitrator shall disclose to the AAA any circumstance likely to affect impartiality,

> including any bias or any financial or personal interest in the result of the arbitration or any past or present relationship with the parties or their counsel. Upon receipt of such information from the arbitrator or another source, the AAA shall communicate the information to the parties and, if it deems it appropriate to do so, to the arbitrator and others. Upon objection of a party to the continued service of a neutral arbitrator, the AAA shall determine whether the arbitrator should be disqualified and shall inform the parties of its decision, which shall be conclusive."

In the present case, appellants "object[ed] . . . to the continued service" of the arbitrator and the AAA "determine[d] whether the arbitrator should be disqualified." It determined Peterson was not disqualified to conduct the arbitration. The next issue we address is the standard for judicial review of that determination.

Respondents assert, and the trial court agreed, that the determination of arbitrator bias was entitled to the same degree of finality that is afforded any other issue submitted for determination by an arbitrator. Respondents therefore contend the AAA decision on this issue must be upheld if it "represents a 'plausible interpretation' of the law and fact and was reached in accordance with a 'minimum standard of fair dealing.' " Appellants contend the trial court should have reviewed the issue of arbitrator bias de novo.

Moncharsh v. Heily & Blase, supra, 3 Cal.4th at p. 11, 10 Cal.Rptr.2d 183, 832 P.2d 899, was decided under the California Arbitration Act. However, in an extended section entitled "The General Rule of Arbitral Finality," the Supreme Court relied upon cases arising under the Federal Arbitration Act as the basis for its discussion and conclusions. The court's analysis in *Moncharsh* provides a useful starting point for our discussion.

"Thus, both because it vindicates the intentions of the parties that the award be final, and because an arbitrator is not ordinarily constrained to decide according to the rule of law, it is the general rule that, 'The merits of the controversy between the parties are not subject to judicial review.' . . .

"Thus, it is the general rule that, with narrow exceptions, an arbitrator's decision cannot be reviewed for errors of fact or law. In reaffirming this general rule, we recognize there is a risk that the arbitrator will make a mistake. That risk, however, is acceptable for two reasons. First, by voluntarily submitting to arbitration, the parties have agreed to bear that risk in return for a quick, inexpensive, and conclusive resolution to their dispute. . . .

" . . . . . .

"*A second reason why we tolerate the risk of an erroneous decision is because the Legislature has reduced the risk to the parties of such a decision by providing for judicial review in circumstances involving serious problems* with the award itself, or *with the fairness of the arbitration process.* [Citing to Code Civ.Proc., §§ 1286.2, subds. (a)-(c)]" (3 Cal.4th at pp. 11-12, 10 Cal.Rptr.2d 183, 832 P.2d 899, italics added.)

A similar theme is apparent in *Commonwealth Corp.* There, the majority opinion emphasizes the importance of a neutral and detached arbitrator, since arbitrators "have completely free rein to decide the law as well as the facts and are not subject to appellate review." (*Commonwealth Corp., supra,* 393 U.S. at p. 149, 89 S.Ct. at p. 339.)[5]

[5] Even in those federal courts that have taken the narrowest possible view of the grounds for disqualification under the Act, there is still an emphasis on independent review of the issue of arbitrator bias and appearance of bias. Thus in *Merit Insurance Co.*

(Footnote continued on following page)

Our research and that of the parties has unearthed but two cases directly addressing the issue of finality of the arbitration administrator's determination of disqualification. Neither is helpful.

In *Van Syoc v. Walter* (App.Div. 1992) 259 N.J.Super. 337, 613 A.2d 490, the Appellate Division of the Superior Court, without discussion or citation of relevant authority, applied the following standard of review: "The trial judge's conclusion that plaintiffs had failed to show that the AAA did not, as a matter of law, act arbitrarily or capriciously is fully supported by the record." (*Id.* 613 A.2d at p. 492.)

In *Freeport Constr. Co. v. Star Forge, Inc.* (1978) 61 Ill. App.3d 999, 19 Ill.Dec. 57, 59, 378 N.E.2d 558, 560, the court held that the state arbitration statute, which used the same language about arbitrator bias as the Act, required de novo consideration of a bias claim. However, the court noted that the AAA rules in question, those for the construction industry, did not assert the finality of any AAA determination on disqualification.

Nor do we find helpful the cases engaging in limited judicial review of arbitration decisions that respondents say are analogous to a disqualification determination. Many of respondents' cases, such as *Orion Pictures v. Writers Guild of America* (9th Cir. 1991) 946 F.2d 722, are labor relations cases arising under the federal Labor

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[5] *continued*

v. Leatherby Insurance Co., supra, 714 F.2d 673, 680, the court wrote: "Although we have great respect for the Commercial Arbitration Rules and the [AAA] Code of Ethics for Arbitrators, they are not the proper starting point for an inquiry into an award's validity under section 10 of the [federal act]. The arbitration rules and code do not have the force of law."

Management Relations Act (LMRA) (29 U.S.C. § 185). The issue in those cases is whether the parties have presented an arbitrable issue. The LMRA permits this prearbitration determination to be made by a federal district court or by the arbitrator, at the parties' election. (See *George Day Const. Co., Inc. v. United Broth. of Carpenters* (9th Cir. 1984) 722 F.2d 1471, 1474-1475.) The cases merely stand for the proposition that a party which elects one forum will not be permitted to turn to the alternative forum later in the proceedings for a de novo determination of arbitrability. (*Id.* at p. 1475.) The Federal Arbitration Act contains no such provision for an election by the parties to have a court determine issues of arbitrator bias before or during an arbitration proceeding; accordingly, the labor law cases on the question of arbitrability are distinguishable.

The nonlabor case upon which respondents rely is *Aerojet-General Corp. v. American Arbitration Ass'n* (9th Cir. 1973) 478 F.2d 248, 252. There, the arbitration rules provided that AAA would choose the venue for arbitration if the parties could not agree. Plaintiff disagreed with AAA's choice of New York, and sued in federal district court in California for an injunction against the New York arbitration. On appeal from an order granting the preliminary injunction, the Court of Appeals reversed.

First, the court noted that the case before it concerned interlocutory judicial intervention in the arbitration. Such interlocutory review was to be available, "if at all, only in extreme cases." (478 F.2d at p. 251.) The court also noted "It was part of the arbitration agreement that the AAA could select a locale for the arbitration if the parties failed to agree on one. . . . When the parties to a contract agree that a factual determination is to be made by a neutral third party that determination is upheld in

the absence of fraud or gross mistake as would necessarily imply bad faith." (478 F.2d at p. 252, fn. 5.)

However, the court also distinguished questions of arbitrator bias from the venue question before it: "An arbitration award must be upheld unless it be shown that there was partiality on the part of an arbitrator [citing *Commonwealth Coatings Corp. v. Continental Casualty Co.*, *supra*, 393 U.S. 145, 89 S.Ct. 337], or that the arbitrator exceeded his authority [citation], or that the award was rendered in 'manifest disregard of the law.' " (*Aerojet-General Corp.*, *supra*, 478 F.2d at p. 252.)[6]

We perceive that arbitrator bias is a fundamentally different question from venue. The AAA has no vested interest in issues of venue. However, in the present case AAA's agent or employee may have been the cause of a significant waste of time and money for the parties to the arbitration, if he failed in his duty to disclose and had to be removed from the arbitration. At the very least, removal of the arbitrator could involve thorny issues about who was to pay for the arbitrator's time up to his removal from the case.

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[6] Similarly in *Bernard v. Hemisphere Hotel Management* (1983) 16 Mass.App.Ct. 261, 450 N.E.2d 1084, the issue was not appearance of bias, but rather the arbitrator's fitness for the position. After the arbitration commenced, it became known the neutral arbitrator on a three-man panel was a convicted felon who had misspelled his name on his biography to hide that fact. On appeal from a trial court order directing the AAA to handle disqualification proceedings in a certain manner, the appellate court wrote that the matter of arbitrator qualifications should be left to AAA with very limited judicial review. The court then stated that, by contrast to the issue of qualifications, "[p]artiality of a neutral arbitrator, however, is one of several post-award issues over which courts have power of decision by statute." (*Id.* 450 N.E.2d at p. 1086.)

It must be remembered that, even though state and federal policy favors private arbitration and the AAA is certainly a respected forum for such arbitration, AAA nevertheless is a business enterprise "in competition not only with other private arbitration services but with the courts in providing—in the case of private services, selling—an attractive form of dispute settlement. It may set its standards as high or as low as it thinks its customers want." (*Merit Ins. Co. v. Leatherby Ins. Co.*, *supra*, 714 F.2d at p. 681.) We cannot ignore the fact that AAA has its own vested interest in a midarbitration declaration of arbitrator disqualification, an interest AAA does not have in such issues as venue and arbitration procedures.

In light of the explicit statutory authorization of judicial determination of "evident prejudice" of arbitrators as interpreted in *Commonwealth Corp.*, *supra*, 393 U.S. 145, 89 S.Ct. 337 we hold that a trial court considering a petition to confirm or vacate an arbitration award is required to determine, de novo, whether the circumstances disclose a reasonable impression of arbitrator bias, when that issue is properly raised by a party to the arbitration.

The trial court in the present case reached the opposite conclusion, favoring limited review of the AAA decision on the issue of appearance of bias. Accordingly, we find it necessary to remand this matter to the trial court for "an evidentiary hearing [at which] the full extent and nature of the relationships at issue may be ascertained." (*Sanko S.S. Co., Ltd. v. Cook Industries, Inc.* (2d Cir. 1973) 495 F.2d 1260, 1263.][7]

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[7] We decline respondents' invitation to make our own de novo review of the "appearance of bias" issue. For reasons described below, resolution of this issue in respondents' favor requires a determination of credibility of witnesses particularly appropriate to a trial court proceeding. (See *Overseas Private Inv. Corp. v. Anaconda Co.* (D.D.C. 1976) 418 F.Supp. 107, 110-111.)

C. *Did the Arbitrator Have a Duty to Disclose His Employment as McCormick's Expert Witness?*

This is a nondisclosure case. It is not a case in which actual bias is alleged. Accordingly, its resolution is guided by *Commonwealth Corp., supra*, 393 U.S. 145, 89 S.Ct. 337. The majority opinion in that case states:

> "[The Act shows] a desire of Congress to provide not merely for *any* arbitration but for an impartial one. It is true that petitioner does not charge before us that the third arbitrator was actually guilty of fraud or bias in deciding this case, and we have no reason, apart from the undisclosed business relationship, to suspect him of any improper motives. But neither this arbitrator nor the prime contractor gave to petitioner even an intimation of the close financial relations that had existed between them for a period of years. We have no doubt that if a litigant could show that a foreman of a jury or a judge in a court of justice had, unknown to the litigant, any such relationship, the judgment would be subject to challenge. . . . [W]e can see no basis for refusing to find the same concept in the broad statutory language that governs arbitration proceedings and provides that an award can be set aside on the basis of 'evident partiality' or the use of 'undue means.' . . . We can perceive no way in which the effectiveness of the arbitration process will be hampered by **the simple requirement that arbitrators disclose to the parties any dealings that might create an impression of possible bias.**" (*Id.* at pp. 147-149, 89 S.Ct. at pp. 338-339, emphasis added; see also *Overseas Private Inv. Corp. v. Anaconda Co., supra*, 418 F.Supp. at p. 110.)

After a thorough review of the cases interpreting *Commonwealth Corp.*, the Ninth Circuit Court of Appeals recently summarized the current state of the law in nondisclosure cases: "Other courts facing the same issue have held that 'evident partiality' is present when undisclos-

ed facts show 'a reasonable impression of partiality.' " (*Schmitz v. Zilveti* (9th Cir. 1994) 20 F.3d 1043, 1046.) " 'Reasonable impression of partiality' . . . is the best expression of the *Commonwealth Coatings* court's holding." (*Id.* at p. 1047.) As phrased by the California Court of Appeal, an arbitrator is "under a legal duty to 'disclose to the parties any dealings that might create an impression of possible bias' " (*Johnston v. Security Ins. Co., supra*, 6 Cal.App.3d at pp. 843-844, 86 Cal.Rptr. 133; see also *Betz v. Pankow, supra*, 16 Cal.App.4th at p. 936, 20 Cal.Rptr.2d 841.)

The parties acknowledge that the foregoing standard establishes the duty of an arbitrator to disclose his business relationships to AAA and to the parties. Similarly, both parties impliedly acknowledge that *if* McCormick had participated in the arbitration hearing on behalf of respondents, nondisclosure of the expert witness relationship would have created a reasonable impression of partiality.[8] (See *Wheeler v. St. Joseph Hosp., supra*, 63 Cal.App.3d 345, 133 Cal.Rptr. 775 [physician arbitrator had served as medical expert witness for the attorneys for a party to the arbitration; award for that party vacated].) The fundamental point of disagreement between the parties arises from McCormick's more limited representation of respondents.

The record is clear that McCormick litigated against appellants and their arbitration attorneys in the trial court, both before and after the court directed the matter to arbitration. The record is also clear that McCormick did

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[8] Respondents' agreement on this point is, of course, qualified by their contention that appellants waived this claim by failing to act on their knowledge concerning Peterson's earlier employment as an expert witness.

not conduct the arbitration hearing on behalf of respondents; that was Wildman's job.

Yet the record is also clear that, on December 2, 1991, John T. Savrnoch of McCormick mailed to Peterson a three-page letter on McCormick letterhead. The letter referenced the pending arbitration and requested issuance of a subpoena on behalf of respondents. This letter did not make reference to any limitation on McCormick's representation of respondents. Instead, it discussed matters of strategy and preparation for the arbitration hearings. The letter concludes: "By this letter, the attorneys for Alfa-Laval respectfully request that a records only deposition subpoena be served upon L & R Engineering, Inc. for the following documents. . . ." Respondents have not directed our attention to a substitution of counsel or any other prearbitration document that informs the arbitrator McCormick no longer represented respondents. It does appear from the record on appeal, however, that McCormick was not on the arbitrator's mailing list for subsequent correspondence in the arbitration.

Peterson apparently received and reviewed the December 2, 1991, letter: A response to the letter, over Peterson's signature, was directed to McCormick's attorney, as well as to the other relevant persons, including attorneys at Wildman. There is no express representation in Peterson's disclosure letters that he did not see the December 2, 1991, letter. Yet, if Peterson did review the December 2 letter, there is no explanation in the record for his repeated representation that he was unaware of McCormick's representation of respondents. And, if Peterson did review the letter and his response to it, there is no explanation how he knew prior to the hearing itself on January 6, 1992 (i.e., during the time when disclosure would have been required), that McCormick would not be

participating. (See Peterson letter, excerpted at p. 704, *ante.*)

On remand, the trial court will be required to determine what Peterson knew and when he knew it. The court will then be required to make a de novo determination of whether the circumstances give rise to a reasonable impression of possible bias. The question before the court will not be, as in most cases, whether the relationship *between the arbitrator and the attorneys* is substantial enough to raise questions. (Compare *Banwait v. Hernandez* (1988) 205 Cal.App.3d 823, 830-831, 252 Cal.Rptr. 647.) It is. (*Wheeler v. St. Joseph Hospital, supra,* 63 Cal. App.3d at p. 372, 133 Cal.Rptr. 775.) Instead, the question is whether the relationship *between the attorneys and the party* to the arbitration is substantial enough to create a reasonable impression of possible bias on the part of the arbitrator.

D. *Did the Arbitrator Have Jurisdiction To Award Attorneys Fees and Costs?*

Appellants contend the arbitrator did not have jurisdiction to award attorney fees and costs. As to both items, appellants contend the award was made more than 30 days after the matter was submitted to the arbitrator for decision. Since the submission established a time within which the arbitration would be concluded by final award, appellants argue that the arbitrator's jurisdiction expired on that date.[9]

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[9] Secondarily, appellants argue that the arbitration clause of the contract did not mention "costs," and "There is consequently no support in the parties' agreements for an award of costs to Alfa-Laval." This issue was conclusively resolved against appellants by

(Footnote continued on following page)

As respondents argue, however, the fundamental fallacy in appellants' argument is that costs and fees *were* awarded in the initial award, entered well within the 30-day jurisdictional period. The final award provides, "Alfa-Laval Food and Dairy Co., a division of Alfa-Laval, Inc., is awarded its attorneys' fees and costs of suit, as against Helm Concentrates, Inc., and Britz, Inc., to be made by supplemental award following receipt and analysis of supporting declaration(s) from attorneys for Alfa-Laval Food and Dairy Co."

Appellants rely on Code of Civil Procedure section 1283.8[10] and cases applying predecessor versions of that section (see, e.g., *Librascope, Inc. v. Precision Lodge No. 1600, Internat. Assn. of Machinists* (1961) 189 Cal.App.2d 71, 76-77, 10 Cal.Rptr. 795) for the proposition that the

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[9] *continued*

the Supreme Court's decision in *Advanced Micro Devices, Inc. v. Intel Corp.* (1994) 9 Cal.4th 362, 383, 36 Cal.Rptr.2d 581, 885 P.2d 994, decided after briefing in the present case was completed.

Advanced Micro Devices held that arbitrators "enjoy the authority to fashion relief they consider just and fair under the circumstances existing at the time of the arbitration, so long as the remedy may be rationally derived from the contract and the breach." Since costs would be awarded to the prevailing party under Code of Civil Procedure section 1032 if this matter had proceeded to superior court trial, such an award is clearly related to the full compensation of respondents for appellants' breach of the contracts, even if the precise costs awarded by the arbitrator could not have been awarded by a court.

[10] Section 1283.8 provides: "The award shall be made within the time fixed therefor by the agreement or, if not so fixed, within such time as the court orders on petition of a party to the arbitration. The parties to the arbitration may extend the time either before or after the expiration thereof. A party to the arbitration waives the objection that an award was not made within the time required unless he gives the arbitrators written notice of his objection prior to the service of a signed copy of the award on him."

30-day award requirement is jurisdictional. Assuming that the procedural requirements of the California Arbitration Act contained in the Code of Civil Procedure govern these proceedings (see *Volt Info. Sciences, Inc. v. Leland Stanford Jr. U.* (1989) 489 U.S. 468, 476-478, 109 S.Ct. 1248, 1254-1255, 103 L.Ed.2d 488), the defect in the award—i.e., failing to establish an exact dollar amount for the award of fees and costs—is at most a defect in the form of the award. Pursuant to Code of Civil Procedure sections 1284 and 1286.6, subdivision (c), the arbitrator retained jurisdiction to correct the form of the award for 30 days after the final award was served on the parties. The date of service was no earlier than April 6, 1992. Accordingly, the May 6, 1992, "supplemental order" was a timely modification of the final order, correcting the form of the attorney fees and costs award.

E. *Did the Trial Court Err in Awarding Prejudgment Interest?*

Finally, appellants contend the trial court erred in awarding prejudgment interest, asserting three separate reasons. We will address each argument briefly.

First, appellants claim the court erred in awarding such interest because it was not demanded in the petition to confirm the award. However, it is well established that, in a contested action, prejudgment interest may be awarded, if the plaintiff is entitled to it, even though the complaint contains no prayer for interest. (*Sears, Roebuck & Co. v. Blade* (1956) 139 Cal.App.2d 580, 294 P.2d 140.) "The rationale of these cases is the simple proposition that in a contested action on a money claim which can be made certain by calculation, the matter of interest for the withholding of the money is 'embraced within the issue' (Code

Civ.Proc., § 508) and the appropriate interest may be allowed even though not prayed for. . . ." (*Id.* at p. 596, 294 P.2d 140.) We can see no reason to distinguish between the award of interest on a complaint and on a petition to confirm an arbitration award.

Appellants' second contention is that respondents' claims were unliquidated—indeed, they were the subject of the "hotly disputed" arbitration, as appellants phrase it—and therefore could not be the subject of an interest award under Civil Code section 3287. That section provides, in part: "Every person who is entitled to recover damages certain . . . and the right to recover which is vested in him upon a particular day, is entitled also to recover interest thereon from that day [with certain exceptions not relevant here]."

Interest was awarded not upon the unliquidated contract claims, as appellants contend, however, but solely upon the arbitration award from the date of the award. As of the date of the award, respondents were entitled to "recover damages certain" through entry of judgment confirming the award. (9 U.S.C. § 9; see Code Civ.Proc. § 1286, 1287.4.)

Third, appellants argues, as to attorney fees and costs, the award of prejudgment interest thereon "pile[s] 'damages' (interest) on top of other 'damages' (attorneys' fees and costs) which were themselves awarded on Alfa-Laval's modest breach of contract damage claim."

This argument again misconceives the subject of the superior court petition. The petition was not for an award of damages and attorneys fees on the original contracts. That underlying dispute was the subject of the arbitration, and had been concluded by the time of the superior court petition to confirm the award. The arbitration award

itself resulted in a new and fixed liability (see Code Civ. Proc., § 1287.6). Regardless of the individual elements that comprised that liability, respondents were entitled to payment of the fixed sum upon issuance of the award.

The arbitration award was the contractual equivalent of a judgment in respondents' favor. In the context of a judicial judgment, it is clear that interest after judgment accrues as to the entire award, including attorney fees. (See 8 Witkin, Cal. Procedure (3d ed. 1985) Enforcement of Judgments, § 40(d), p. 58.) The prejudgment interest awarded respondents served the same purpose here. Although the interest was pre-"judicial judgment," it was post-"contractual judgment." Any result that denied respondents this post-award interest would punish them for using arbitration instead of the court system to resolve their dispute with appellants.

DISPOSITION

The judgment is reversed and the matter is remanded to the trial court for a new hearing on appellants' petition to vacate the arbitrator's award and respondents' petition to confirm the award, limited to the single issue, whether there was evident partiality on the part of the arbitrator. If the court finds "evident partiality," then arbitration proceedings shall commence anew. If the court finds to the contrary, the judgment shall be reinstated. Appellants are awarded their costs on appeal.

ARDAIZ, P.J., and HARRIS, J., concur.

[Filed August 10, 1995]

Fifth Appellate District No. F020306
S047194

IN THE SUPREME COURT OF CALIFORNIA

BRITZ INCORPORATED Et Al.,

Appellants

v.

ALFA-LAVAL FOOD & DAIRY COMPANY Et Al.,

Respondents

Respondents' petition for review DENIED.

LUCAS
Chief Justice

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SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

BRITZ, INC., HELM CONCENTRATES, INC., and HELM TOMATOES, INC., Plaintiffs,	) CASE NO. 425766-3
vs.	) Date: November 13, 1990) Time: 9:30 a.m.
ALFA-LAVAL FOOD & DAIRY CO., ALFA-LAVAL CREDIT AB, THOMAS W. HINCZ, W. STANLEY PRITCHARD, THOMAS BAILEY, and DOE 1 through DOE 20, inclusive, Defendants.	) Dept: 1) Trial Date: None

MEMORANDUM OF POINTS AND AUTHORITIES
IN OPPOSITION TO
PETITION TO COMPEL ARBITRATION

TABLE OF CONTENTS AND TABLE OF AUTHORITIES

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SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

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MEMORANDUM OF POINTS AND AUTHORITIES
IN OPPOSITION TO
PETITION TO COMPEL ARBITRATION

PRELIMINARY STATEMENT

The pending action is an action for rescission of three related contracts, a contract for purchase and sale of aseptic tomato paste and crush equipment, a contract for the purchase of sterile bags, and a contract for the lease of filling machines for use with the paste and crush equipment.

The Complaint seeks rescission of the three contracts. The grounds for rescission are fraud by misrepresentation, fraud by nondisclosure of known facts, and negligent misrepresentation. In California, negligent misrepresentation is a form of actual fraud. (*Continental Airlines, Inc. v. McDonnell Douglas Corp.*, (1989) 216 CA3d 388, at 404).

The Complaint alleges that during the negotiations between the parties, the ALFA-LAVAL defendants falsely represented that the clean-in-place ("CIP") system for the aseptic tomato paste and crush equipment was fully automated, that the aseptic paste equipment could be operated continuously, with at most a shut-down and CIP, including inspection of wear parts, for two to three hours once every ten to twelve days, that fourteen contherms (heat exchangers) would be adequate, that the seals, including the internal O-rings, used for the contherms would have a normal expected lifetime of 2900 hours, and that the system being presented by the ALFA-LAVAL defendants had been used successfully at other locations to produce aseptic tomato paste.

Section 1.4 of the agreement for the purchase of the equipment (Exhibit "A" attached to the Complaint) states as follows: "The system is cleaned by adding concentrates into the balance tank. The centrifugal pump will then circulate the solutions through the system."

Section 1.1 of the same agreement states as follow (emphasis added):

> "The purpose of this project is to produce aseptic tomato paste and crush.
>
> *The most common mode of operation is continuous with stops only for breakdown repairs. The approach taken in this proposal allows for such a mode of operation*, although it is not a recommended plant operation plan. Planned shut-downs with minor maintenance will save the equipment, increase plant utilization and given an overall more economic operation. *The design presented here allows for both modes of operation. We recommend one shut-down and CIP including inspection of wear parts once every ten-twelve days. A shut-down would last two to three hours.*"

All of the representations made by the ALFA-LAVAL defendants were false. (Complaint, paragraph 13, page 6; and Declarations of CLAUDE LUSTER and ROBERT GLASSMAN filed herewith).

The following allegations appear in paragraph 15, pages 6-7, of the Complaint:

> "The foregoing false representations were made with the intent to induce plaintiffs to execute the foregoing contracts (Exhibits "A", "B", and "C"), including but not limited to, the arbitration provisions included in those contracts. The false representations went not only to the contracts as a whole, but to the agreements to arbitrate, as well. Plaintiffs were led to believe by defendants that plaintiffs had to agree to arbitration as a *sine qua non* for acquisition of equipment, bags and filling machines."

The declarations filed herewith by plaintiffs' negotiators, CLAUDE LUSTER and ROBERT GLASSMAN, state that the arbitration provisions were take-it-or-leave-it.

Plaintiffs were being offered a revolutionary new CIP system, a fully automated system, which could save them great sums of money, and they were led to believe that to obtain the system, they had to agree to arbitration. They were led to believe that they had to agree to arbitration to obtain the research and development capability of an international two billion dollar company.

In fact, the CIP system was not fully automated, the aseptic paste equipment could not be operated continuously, with at most a shut-down and CIP, including inspection of wear parts, for two to three hours once every ten to twelve days, and the results were disastrous.

The key-note of defendants' Point and Authorities seems to be that there could not have been fraud in inducing the execution of the contracts or the arbitration clauses because "the contracts involved here were the result of extensive negotiations" and one of plaintiffs' negotiators was an attorney. However, notwithstanding defendants' views, fraud can occur even in sophisticated settings. *Continental Airlines v. McDonnell Douglas Corp.* (1989) 216 CA3d 388, an action by a major airline against a major aircraft manufacturer for misrepresentation by the manufacturer in protracted negotiations for purchase and sale of aircraft, is a recent example.

Defendants also argue that "Now that HELM has used the equipment and bags for its 1990 seasonal tomato crop (Complaint, par. 20), it has decided that it does not want to pay the balances due on the purchase agreements". The argument has to be with tongue-in-cheek. Once the tomato season started and plaintiffs began to use the equipment, plaintiffs were between the proverbial rock and hard place: Plaintiffs could limp along with what they had received from defendants, or plaintiffs could shut-down completely.

GROUNDS OF OPPOSITION

In opposing arbitration, plaintiff's position is two-fold. Plaintiffs claim fraud in the inducement of the contract generally and also claim fraud directed to the arbitration clause.

The Federal Arbitration Act

The Federal Arbitration Act, Title 9, Sections 1-14, United States Code, herein "the Arbitration Act", is applicable to defendants' Petition to Compel Arbitration. The Arbitration Act is applicable to a "written provision in . . . a contract evidencing a transaction involving [interstate] commerce . . . .". (See 9 U.S.C.A. § 2). All of the transactions involved in the case at bar involved interstate commerce. (See Declaration of CLAUDE LUSTER filed herewith, pp. 4-5).

Section 2 of the Arbitration Act, (9 U.S.C.A. § 2) provides that agreements to arbitrate shall be "valid, irrevocable and enforceable, *save upon such grounds as exist in law or in equity for the revocation of any contract*". (Emphasis added). The California arbitration statute has a similar provision. (C.C.P. § 1281.2(b)).

Under the Arbitration Act, the parties are entitled to a jury trial of the issue whether a valid agreement to arbitrate exists. (9 U.S.C.A. § 4). "The issue, 'should not be determined on affidavits, but rather a full trial should be had.' " (*Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, (1977) 67 CA3d 19, 24. Accordingly, in ruling on a petition to compel arbitration, the court should merely determine whether the plaintiff has alleged sufficient facts of fraud directed at the making of the arbitration agreement to warrant a trial on the issue of the validity of the agreement.

In the pending action, plaintiffs clearly allege sufficient facts of fraud directed at the making of the arbitration agreement to warrant a trial on the issue of the validity of the agreement. In that regard, paragraph 15, pages 6-7, of the Complaint alleges as follows:

> " 15. The foregoing false representations were made with the intent to induce plaintiffs to execute the foregoing contracts (Exhibits "A", "B", and "C"), including but not limited to, the arbitration provisions included in those contracts. The false representations went not only to the contracts as a whole, but to the agreements to arbitrate, as well. Plaintiffs were led to believe by defendants that plaintiffs had to agree to arbitration as a *sine qua non* for acquisition of the equipment, bags, and filling machines."

For the reasons set forth above, plaintiffs object to, and plaintiffs move to strike, the affidavit of GOREN OLSSON attached to defendants' Points & Authorities. Plaintiffs submit herewith the declarations of ROBERT GLASSMAN and CLAUDE LUSTER without waiving the foregoing objection, for the limited purpose of placing the declarations before the Court should the Court determine that the consideration of affidavits/declarations is appropriate.

In *Prima Paint v. Flood & Conklin* (1967) 338 U.S. 395, 87 S. Ct. 1801, 18 L. Ed. 2d 1270, a case arising under the Arbitration Act, the United States Supreme Court considered the effect of fraud in an agreement containing an arbitration clause. In *Prima Paint*, the plaintiff had entered into a consulting agreement with the defendant following a sale by plaintiff to defendant of plaintiff's business. The plaintiff, in resisting arbitration, alleged that at the time it entered into the consulting agreement with defendant, defendant fraudulently concealed defendant's insolvency. The Supreme Court held that ar-

bitration clauses are "separable" from the contracts in which they are included, that claims of fraud in the inducement of the contract generally should be resolved by arbitration, *but that claims of fraud directed to the arbitration clause itself should be resolved by the court.* (388 U.S. 402-404).

The California Decisions

The issue addressed by *Prima Paint*, the effect of fraud in the formation of an agreement, containing an arbitration clause, has been addressed by six California Appellate Court decisions. The California decisions are *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc*, (1977) 67 CA3d 19, *supra*, *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 C.3d 312, *Ford v. Shearson Lehman American Express, Inc.* (1986) 180 CA3d 1011, *Herman Feil, Inc. v. Design Center of Los Angeles* (1988) 204 CA3d 1406, *Green v. Mt. Diablo Hospital District* (1989) 207 CA3d 63, and *Strotz v. Dean Witter Reynolds, Inc.* (1990) 223 CA3d 208.

Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., (1977) 67 CA3d 19, was an action against a stock brokerage firm by a client for losses and damages due to discretionary sales and purchases of securities under a lending agreement. The trial court denied defendants' petition to compel arbitration pursuant to an arbitration clause in the lending agreement. The Court of Appeal affirmed. The Court of Appeal held that the Arbitration Act is applicable to California's courts in the case of a contract evidencing a transaction involving interstate commerce (67 CA3d 19, 25). The Court of Appeal considered *Prima Paint* and its progeny, and concluded that "where it is alleged that fraud either induced the arbitration clause itself, or permeated the entire agreement including the arbitration

clause, that issue will be determined judicially and not by arbitration." (67 CA3d 19, 27).

In *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 C.3d 312, the California Supreme Court considered an action by a lessee against a lessor arising out of a lease of office premises, in which it was alleged that the leased premises were untenantable by reason of defective air-conditioning. The lessee claimed that it had been fraudulently induced to enter into the lease agreement by representations by the lessor that the premises were in tenantable condition when in fact the air-conditioning was inadequate, making the premises untenantable. The trial court denied the lessor's petition to compel arbitration on the basis of the lessee's claim that it had been fraudulently induced to enter into the lease agreement. The Supreme Court reversed, holding that "claims of fraud in the inducement of the contract (as distinguished from claims of fraud directed to the arbitration clause itself) will be deemed subject to arbitration." (35 C3d 312, 323). However, in so holding, the Supreme Court notes with approval the Court of Appeal decision in *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc., supra*), holding that fraud which "permeated the entire contract including the arbitration provision" vitiates the arbitration agreement and requires judicial determination. (35 C3d 312, 323, fn. 8).

In *Ford v. Shearson Lehman American Express* (1986) 180 CA3d 1011, plaintiff brought action against several parties, including a securities broker and investment advisor, for damages based on an alleged scheme by defendants to defraud him. The trial court denied the broker's motion to compel arbitration of plaintiff's disputes with it pursuant to customer brokerage agreements plaintiff had executed. The Court of Appeal affirmed. The Court

of Appeal held that the Arbitration Act was applicable to the dispute between the parties and concluded that "the threshold issues that whether the agreements were procured by fraud or not voluntarily assented to must be initially determined by a court and not by arbitration." (180 CA3d 1011, at 1024). The Court of Appeal approved and applied the permeation doctrine. It also held that neither *Prima Paint* nor *Ericksen* were applicable, on the grounds that they involved allegations of fraud in the performance of the contract rather in the making of the contract. (180 CA3d 1011, 1023).

In *Herman Feil, Inc. v. Design Center of Los Angeles* (1988) 204 CA3d 1406, the proceeding involved was a proceeding by a landlord to confirm an arbitration award for a tenant's breach of a commercial real estate lease. The Court of Appeal stated that neither party had "addressed the key issue directly, i.e. whether or not, under our state arbitration statute, a claim specifically charging fraud as to the arbitration clause itself may be referred to arbitration for disposition or must be traditionally determined by litigation in the trial courts." However, the Court of Appeal did not reach or resolve that issue. Instead, it concluded that if the issue already had been determined in the course of arbitration, as it had, the determination would be controlling, and in any event, there was no evidence whatsoever of fraud. (204 CA3d 1406, 1416-1417).

It should be noted that both *Ericksen* and *Feil* are cases involving the California arbitration statute, not the Arbitration Act. *Main* and *Ford* involve the Arbitration Act, as does the pending action.

Green v. Mt. Diablo Hospital District (1989) 207 CA3d 63, is another case involving the state statute. *Green* involved alleged illegality of a termination agreement reached between a hospital district and its chief executive officer.

The agreement included an arbitration clause. The officer sought to compel arbitration under the state statute. The trial court denied the petition to compel arbitration. The Court of Appeal affirmed. In so doing, the Court of Appeal followed *Main* and *Ford*, and stated as follows:

> "Fraud that permeates the entire contract, including the arbitration provision, vitiates the arbitration and requires judicial determination (id., at p. 323, fn. 8, citing *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal. App.3d 19, 27 [136 Cal Rptr. 378]. Although the *Ericksen* court found the permeation doctrine to be inapplicable to the facts of that case, the court in *Ford v. Shearson Lehman American Express, Inc.* (1986) 180 Cal. App.3d 1011 [225 Cal. Rptr. 89t], applied the permeation doctrine to a claim under the federal Arbitration Act. In *Ford, supra*, the court distinguished *Ericksen* by noting that the fraud asserted in *Ericksen* concerned fraud in the performance of the contract and that the fraud alleged was a " 'disappointed expectation' " concerning such performance. (*Ford, supra*, 180 Cal. App. 3d at pp. 1019, 1022.) The fraud alleged did not concern the " 'making' " or procurement of the contract itself. (Id., at p. 1019.) Since Ford alleged that he did not voluntarily assent to the contract, "the fraud . . . goes to the 'making' of the contract, which, if proven, would void the agreements and the arbitration clause contained therein." (Ibid.) Ford sufficiently alleged that he was induced by fraud to make the agreements and that his assent to the agreements was involuntary. The issue of fraud and undue influence must first be determined by a court, not by arbitration. Id., at p. 1023.)"

In *Strotz v. Dean Witter Reynolds, Inc.* (1990) 223 CA3d 208, the trial court denied defendants' petition to compel arbitration, based on allegations in plaintiff's complaint that defendants had fraudulently induced her to sign the contract which contained the agreement to arbitrate, and

that the fraud permeated the entire contract, including the agreement to arbitrate. The Court of Appeals affirmed. The Court of Appeals declined to follow the broad permeation doctrine approved in *Main*, in *Ford*, and in *Green*, but nevertheless, held that fraud directed at the making or performance of the arbitration agreement is to be determined by the court. (223 CA3d 208, at 217). In discussing allegations of fraud directed at the arbitration clause, the Court of Appeals discusses, as illustrations, allegations "that the plaintiffs were led to believe that they had to agree to arbitration or that the arbitration agreement was part of a fraudulent scheme or that the parties never intended to agree to arbitration". (223 CA3d 208).

In *Strotz*, a Petition for Rehearing was filed on September 24, 1990, and was denied. A Petition for Review was filed on October 5, 1990. The California Supreme Court File No. is S017778. Accordingly, *Strotz* is not cited at this time for precedential value, but rather because the Court of Appeal's discussion is enlightening. Also, by the time of the hearing on defendants' motion herein (November 13, 1990), the Petition for Review may be denied, or alternatively, this Court may wish to defer its ruling for a short time to await the outcome of the Petition for Review.

The Pending Case

Plaintiffs' Complaint, as well as the declarations of ROBERT GLASSMAN and CLAUDE LUSTER if the Court determines that the consideration of affidavits/declarations is appropriate, clearly sets forth fraud which permeated the entire contracts, including the arbitration provisions. The fraud was directed "not only to the contracts

as a whole, but to the agreements to arbitrate, as well". (Complaint, paragraph 15, page 6, lines 27-28).

The weight of authority (*Main*, *Ericksen*, *Ford*, and *Green*) compels the conclusion that the permeation doctrine is alive and well in California.

Defendants argue that the permeation doctrine applies only if an agreement, including the agreement to arbitrate, does not result from "arms length negotiations". However, the Arbitration Act allows the courts to give relief where the party opposing arbitration presents "well-supported claims that the agreement to arbitrate resulted from the sort of *fraud or* overwhelming economic power that would provide grounds "for the revocation of any contract." (*Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.* (1985) 473 U.S. 614, at 627, 105 S.Ct. 3346, at 3354, 87 L. Ed. 2d 444; Emphasis added).

Alternatively, if there is any doubt regarding permeation, the California and federal decisions uniformly held that claims of fraud directed to the arbitration clause itself should be resolved by the court.

CONCLUSION

For the reasons set forth above, the Petition to Compel should be denied.

Dated: October 31, 1990

FRAME & MATSUMOTO

By: /s/ TED R. FRAME,
Attorney for Plaintiffs

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WYATE & CARRUTH
1331 Fulton Mall
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(209) 442-1150

Attorney For: Defendants/Petitioners

SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

BRITZ, INC., HELM CONCENTRATES, INC., and HELM TOMATOES, INC., Plaintiffs,	CASE NO. 425766-3
vs.	DATE: November 13, 1990 TIME: 9:30 A.M.
ALFA-LAVAL FOOD & DAIRY CO., ALFA-LAVAL CREDIT AB, THOMAS W. HINCZ, W. STANLEY PRITCHARD, THOMAS BAILEY, and DOE 1 through DOE 20, inclusive, Defendants.	DEPT: 1 TRIAL DATE: None

DEFENDANTS/PETITIONERS REPLY TO MEMORANDUM IN OPPOSITION TO PETITION TO COMPEL ARBITRATION

TABLE OF CONTENTS

[Omitted in printing.]

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SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

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DEFENDANTS/PETITIONERS REPLY TO MEMORANDUM IN OPPOSITION TO PETITION TO COMPEL ARBITRATION

PRELIMINARY STATEMENT

The dispute in this case is rather simple. The plaintiffs claim that the equipment purchased from Alfa-Laval did not perform as warranted. In order to avoid their negotiated agreement to arbitrate this dispute, the plaintiffs have attempted to mislead this court into believing that the issue to be decided is whether there was fraudulent inducement of the contract. This is not true. Plaintiffs' objective is to entice the court into ruling upon all material elements of their breach of express warranty claims by using the guise of a fraud-in-the inducement theory. The only issues to be addressed on the Petition to Compel Arbitration are (1) where should the issue of claimed fraud in connection with arbitration clauses be decided, and (2) if this court elects to resolve this narrow issue, was there fraud in the agreement to arbitrate. Hence, the bulk of the plaintiffs' argument in opposition to arbitration is legally irrelevant. Once this court determines there was no fraudulent inducement of the arbitration agreement, all of the plaintiffs' claims, including fraudulent inducement of the contract, must be decided by arbitration.

The first attempt by the plaintiffs to confuse the court and deflect attention from the true issues to be decided is to mis-cite *Continental Airlines, Inc. v. McDonnell Douglas Corp.* (1989) 216 CA3d 388, for the proposition that fraud can occur in sophisticated settings involving protracted negotiations. (Opposition To Petition To Compel Arbitration, p. 4). *Continental Airlines*, did not involve enforcement of an arbitration agreement. Rather, in *Continental Airlines*, the issue of fraud was decided in the courts because *neither party sought to compel arbitration.* Therefore, *Continental Airlines* is completely irrelevant to this case.

GROUNDS IN SUPPORT

There is No Evidence of Fraudulent Inducement of The Arbitration Agreement

The plaintiffs are compelled to seek to confuse the issue of fraud in the inducement of the *entire* contract with the narrower issue of fraud in securing an agreement to arbitrate disputes. This obfuscation is necessary because any claim of fraud in the inducement of the arbitration agreement is totally unsupported by any facts. The plaintiffs have admitted in sworn affidavits that the matter of arbitration was specifically negotiated over a ten day period in California by the top executives of Britz, one of whom is a licensed lawyer. (Affidavits of Claude Lester and Robert Glassman). The plaintiffs fail to mention in their Memorandum that the negotiation of the arbitration agreement was supervised by their attorney, Ted Frame. In fact, Ted Frame drafted and submitted the arbitration agreement that the plaintiffs now contend was induced by Alfa-Laval's fraud. (Exhibit A hereto, p. 3, par. 3). It defies any sense of logic or common sense to believe that a party can negotiate, draft, and agree to an arbitration agreement and then claim fraudulent inducement of that very same agreement.

The Permeation Doctrine is a Narrow Exception

Because the facts completely belie any contention that there was fraud in the inducement of the arbitration agreement, the plaintiffs' only chance at avoiding their arbitration commitment is the permeation doctrine. The plaintiffs are obviously hoping that the permeation doctrine can be used to present the full merits of their warranty claims to the court and hereby eliminate any necessity for arbitration. However, this is not a permeation case.

The permeation doctrine is a very limited exception to the general rule that fraud in the inducement of a contract must be decided by arbitration. It has never been applied to situations involving arms length negotiations of an arbitration agreement. To the extent that this doctrine exists, it does so only in cases involving breaches of fiduciary duty, or when the parties allege they never really agreed to anything. *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 C.3d 312; *Ford v. Shearson Lehman American Express, Inc.* (1986) 180 CA3d 1011; *Main v. Merrill Lynch, Pierce, Fenner & Smith* (1977) 67 CA3d 19. Neither of these fact patterns exists in this situation.

The foundation of the plaintiffs' permeation doctrine argument is *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967). The court in *Prima Paint* held simply that as a matter of federal substantive law, in ruling on a petition to compel arbitration or an application for a stay of court proceeding pending arbitration, the trial court "*may* consider only issues relating to the making and the performance of the agreement to arbitrate" and *may not* "consider claims of fraud in the inducement of the contract generally." 388 U.S. at 404 (emphasis added). *Prima Paint* is not, as the plaintiffs suggest, a Supreme Court mandate for broad application of the permeation doctrine. Rather, court application of the permeation doctrine has been narrowly construed. *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 C.3d 312.

A key case relied on by the plaintiffs is *Ericksen, Arbuthnot, McCarthy, Kearney & Walsh, Inc. v. 100 Oak Street* (1983) 35 C.3d 312. However, in *Ericksen*, the California Supreme Court found that the permeation doctrine was inapplicable and strongly cautioned against expansion

of the doctrine. 35 C.3d at 323-24. In fact, this case is directly contrary to the plaintiffs' allegation that doubts as to fraud should be resolved by the courts. *Id.* In denying application of the permeation doctrine, the court noted that the difference between a breach of contract and fraudulent inducement "turns upon determination of a party's state of mind at the time the contract was entered into" and a court "ought not close . . . [their] eyes to the practical consequences of a rule which would allow a party to avoid an arbitration commitment by relying upon that distinction." *Id.* In fact, the California Supreme Court stated the permeation doctrine is only applicable when the party seeking to avoid arbitration denies having agreed to *anything*. 35 C.3d at 323, fn. 8.

Further attempts by the plaintiffs to minimize the strong language of the California Supreme Court are of no avail. The plaintiffs point out that *Ericksen* was decided under the California Arbitration Act, not the Federal Arbitration Act. However, the California Supreme Court firmly stated that Code of Civil Procedure section 1281.2 (which calls for arbitration unless there are grounds for revocation of the agreement) and the Federal Arbitration Act (which requires arbitration "save upon such grounds as exist at law or in equity for the revocation of any contract") are essentially expressions of the same rule. 35 C.3d at 323.

Another case cited by the plaintiffs in support of the permeation doctrine is *Herman Feil, Inc. v. Design Center of Los Angeles* (1988) 204 CA3d 1406. In *Herman Feil*, the court once again warned against expanding the permeation doctrine and refused to apply it. 204 CA3d at 1417. Following *Ericksen*, as this court must, the *Herman Feil* court stated that the permeation doctrine is applicable only where the party seeking to avoid arbitra-

tion denies agreeing to *anything*. *Id.* The court further found that there was nothing persuasive about the asserted fraud and that there was no relationship of confidence or trust that might make the permeation doctrine applicable. 204 CA3d at 1418. Rather, as with the dispute between Alfa-Laval and Britz, the contracts were executed after "arms length negotiation." *Id. Herman Feil* and this dispute involve a "typical commercial dispute for which arbitration was admirably suited, to render by fast and efficient means, a fair determination on the merits." *Id.*

This Case Does Not Fit Into The Narrow Permeation Exception

The plaintiffs cite several California cases in support of their argument that the narrowly construed permeation doctrine should be applied in this case. Essentially, the plaintiffs would like this court to believe that merely because the permeation doctrine has been recognized by some California courts, the doctrine must be applied in this case. However, even the most cursory analysis of cases applying this doctrine demonstrates the fallacy of the plaintiffs' position.

Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc. (1977) 67 CA3d 19, has been cited by the plaintiffs as support for application of the permeation doctrine. In *Main*, the plaintiff, a conservator of her invalid husband's estate, sought investment advice from Merrill Lynch. 67 CA3d at 31. The plaintiff was "aged and unschooled in business affairs" and relied exclusively on trust and confidence that Merrill Lynch would properly manage her account. *Id.* The defendants breached that trust by asking the plaintiff to sign a loan agreement that allowed Merrill Lynch to margin her account without informing her of the con-

tents. *Id.* The result was an unexpected loss to the plaintiff of over $83,000. 67 CA3d at 24. The loan agreement also contained a "boilerplate" arbitration clause that stated the plaintiff agreed to submit all claims to arbitration. 67 CA3d at 30.

In applying the narrow permeation doctrine, the *Main* court found that the plaintiff did not realize she signed an arbitration agreement and there never was any real agreement to submit the dispute to arbitration. *Id.* The *Main* court also held that grounds existed for revocation of the arbitration agreement because the defendants breached their fiduciary duty to disclose the material nature of the documents. 67 CA3d at 31-32. Hence, the question of fraud was to be decided in a court. 67 CA3d at 32.

The facts of the present dispute are in no way analogous to those in *Main*. First, both Alfa-Laval and Britz are sophisticated in business affairs. Second, no fiduciary relationship exists. Third, the arbitration agreement was not "boilerplate." Lastly, given the fact the agreements were negotiated, there can be no realistic argument that the plaintiffs did not know what they were signing. Therefore, *Main* cannot support the plaintiffs' position.

Another case relied on by the plaintiffs in which the permeation doctrine was applied is *Ford v. Shearson Lehman American Express*, (1986) 180 CA3d 1011. In *Ford*, the plaintiff had the majority of his $25 million in assets misappropriated from his account at Shearson. *Id.* This misappropriation was allegedly accomplished when Shearson breached its fiduciary duty to the plaintiff by allowing other persons to collect the proceeds from stock owned by the plaintiff. 180 CA3d at 1017. In denying the broker's motion to compel arbitration, the court relied on two facts. First, the broker breached his fiduciary duty by a "scheme

of domination, control, concealment, misrepresentation and advantage gained by virtue to the fiduciary position" of the broker. 180 CA3d at 1028. Second, the court held that the plaintiff was not aware that he signed an arbitration agreement. *Id.*

As with *Main*, *Ford* is completely inapposite to the present dispute. There is no fiduciary relationship between Alfa-Laval and Britz. Further, there is no claim that the plaintiffs did not know they were signing an arbitration agreement.

Still another case relied on by the plaintiffs is *Green v. Mt. Diablo Hosp. Dist.*, (1989) 207 CA3d 63. In *Green*, taxpayers sought declaratory relief that an employment contract was void and unconstitutional. 207 CA3d at 69. The *Green* court denied the petition to compel arbitration not because fraud permeated the contract, but because there were "sufficient grounds alleging illegality of the underlying agreement." 207 CA3d at 67. These allegations implied that the entire agreement was "illegal from its inception and against public policy." *Id.* In contrast, there is no claim that the agreement between Alfa-Laval and Britz is illegal. Therefore, *Green* provides no support for the contention that the permeation doctrine should be applied in the instant case.

Lastly, the most current case cited by the plaintiffs, *Stortz v. Dean Witter Reynolds, Inc.*, (1990) 223 CA3d 208, 272 Cal. Rptr. 680, refused to utilize even the *limited* permeation doctrine applied in *Main* and *Ford*. In *Stortz*, the defendants allegedly lost $180,000 of the plaintiff's funds by investing in high risk index options. 272 Cal. Rptr. at 682, fn. 1. Dean Witter also allegedly stated that the investments were low risk and concealed the full extent of the plaintiffs losses. 272 Cal. Rptr. at 682. The *Stortz*

court refused to compel arbitration for the simple reason that the plaintiff did not realize she had signed contracts. 272 Cal. Rptr. at 686-87. If a party is unaware they are signing contracts, they are unaware they are agreeing to arbitration by signing a contract. 272 Cal. Rptr. at 687. Given that the *Stortz* court did not apply the permeation doctrine and that the plaintiffs in the instant litigation clearly knew they were signing contracts, *Stortz* provides no support whatsoever for applying the permeation doctrine in the present dispute.

Common sense and the case law overwhelmingly dictate the permeation doctrine not be applied here. If the plaintiffs' argument was correct, parties could merely cry "fraud" and totally avoid every agreement to arbitrate. This would be contrary to the longstanding Federal and California policy favoring arbitration and of resolving all doubts in favor of arbitration. *E.g., O'Malley v. Wilshire Oil Co.*, (1963) 59 C.2d 482, 490-91; *Freeman v. State Farm Mutual Auto Ins. Co.*, (1975) 14 CA3d 473, 483; *Loscalzo v. Federal Mutual Ins. Co.*, (1964) 228 CA2d 391, 398.

The California Procedural Rules Apply

The plaintiffs also erroneously construe the relationship between the Federal Arbitration Act (9 U.S.C.A. § 2) and the California Arbitration Act (C.C.P. §§ 1280-1294.2). The plaintiffs are correct in stating that the Federal Arbitration Act is applicable to written provisions in a contract evidencing interstate commerce. (9 U.S.C.A. § 2). They are also correct in stating that this dispute involves interstate commerce. However, when an arbitration action is brought in state court, the Federal Arbitration Act applies only as to matters of substantive law. *Main v. Merrill Lynch,*

Pierce, Fenner & Smith, Inc., (1977) 67 CA3d 19, 24-25. *See also Green v. Mt. Diablo Hosp. Dist.*, (1989) 207 CA3d 63; *Ford v. Shearson Lehman/American Express, Inc.*, (1986) 180 CA3d 1011.

California state courts cannot apply federal procedural law. Under California civil procedure, whether an arbitration agreement is valid is to be decided in a summary fashion "in the manner and upon the notice provided for the making and hearing of motions, . . ." (C.C.P. § 1290.2). Further, the court in *Herman Feil*, determined that fraud in the inducement of an arbitration agreement may be decided by an arbitrator. 204 CA3d at 1416-17.

Lastly, despite the plaintiffs' contention to the contrary, the *Main* decision does not stand for the general notion that under *federal* procedural rules a judge should merely determine whether the plaintiff has alleged sufficient facts of fraud directed at the making of the arbitration agreement to warrant a trial on the issue of the validity of the agreement. In *Main*, the defendants alleged only that an arbitration agreement was entered into, that they were ready and willing to submit the controversy to arbitration and that the plaintiff refused to do so. 67 CA3d at 29. Unlike this case, the *Main* plaintiff did not file a response, but rather stood on the complaint. *Id.* Therefore, only a question of law was presented. It was only natural that the sole issue for the court was whether the plaintiff pleaded sufficient facts to support their charge. *Id.* Thus, the plaintiffs' contention that federal procedural rules merely require a cursory pleading effort is misstated as well as misdirected.

The Pending Case

The court has discretion in the present matter to decide whether the arbitration agreements were fraudulently induced. The plaintiffs have failed to present any evidence that would support fraudulent inducement of their arbitration agreements. In fact, the evidence presented by the plaintiffs strongly suggests that both parties agreed "with their eyes wide open" to arbitrate disputes arising under the contracts. The plaintiffs knew exactly what they were doing. Tough negotiations with each side giving a little and getting a little took place here. The plaintiffs agreed to arbitrate all disputes and had their own attorney draft the language they now wish to avoid. There was no fraud in reaching the agreement to arbitrate.

Finally, the plaintiffs cannot bootstrap the permeation doctrine into this case as a means of securing a judicial finding on their warranty claims. This doctrine has been narrowly applied only to disputes where the parties did not agree to arbitrate or cases of breach of fiduciary duty. Neither situation is present in this case. The permeation doctrine cannot be applied here. Because the plaintiffs have failed to show any fraud in connection with their agreement to arbitrate, this case must be dismissed or stayed so that the already pending arbitrations may go forward.

CONCLUSION

For the reasons set forth above, the PETITION TO COMPEL ARBITRATION should be granted, the MOTION TO STAY PROCEEDINGS should be granted and the DEFENDANTS/PETITIONERS should be awarded costs and fees incurred by reason of this proceeding.

Dated: November 9, 1990

McCORMIC, BARSTOW, SHEPPARD,
WYATE & CARRUTH

By: /s/ OLIVER W. WANGER,
Attorney for
Defendants/Petitioners

August 4, 1992

72 T199 2101 90 RM
Alfa-Laval Food And Dairy Co.,
A Div. Of Alfa-Laval, Inc.
—and—
Helm Concentrates, Inc., Britz,
Inc., & Helm Tomatoes, Inc.

AAA Rules: Commercial

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Ted R Frame Attorney
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Frame & Matsumoto
PO Box 895
Coalinga, CA 93210

Dear Parties:

The Association has received and reviewed the parties various correspondence concerning the disclosure issue of the Arbitrator raised by Attorney Frame. We have also received the latest correspondence of Attorney White dated July 31, 1992.

Upon careful review by the Association and in accordance with Section 19 of the Commercial Arbitration Rules, it is the determination of the Administrator that the challenge submitted by Respondent to the Arbitrator's continued service be denied and Arbitrator John E. Peterson's appointment and continued service on the above-captioned matter is reaffirmed.

Sincerely,

/s/ Rocco M. Scanza
Assistant Regional Director
RMS/ct

Encl.

cc: John E. Peterson, Esq.

February 18, 1993

72 T199 2101 90
Alfa-Laval Food And Dairy Co.,
A Div. Of Alfa-Laval, Inc.
—and—
Helm Concentrates, Inc., Britz,
Inc., & Helm Tomatoes, Inc.

AAA Rules: Commercial

VIA FAX

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Joan M Dolinsky Attorneys
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Los Angeles, CA 90012

Dear Parties:

The Association, after carefully considering the parties' contentions, hereby reaffirms the appointment of John E. Peterson as the Arbitrator in the above captioned matter.

Additionally we received a telecopied letter dated February 18, 1993, from Attorney Vorzimer, advising that Respondents Helm Concentrates, Inc., Britz, Inc. and Helm

Tomatoes) Inc. will file an action in Superior Court seeking a temporary restraining order against the American Arbitration Association in this proceeding.

We believe it is neither necessary nor proper to include the Association nor the Arbitration Panel as parties to any legal proceedings between the parties in connection with this arbitration. Section 47 of the Rules states that "Neither the AAA nor any Arbitrator in a proceeding under these Rules is a necessary party in judicial proceedings relating to the arbitration."

Were the AAA to become involved in judicial proceedings between the parties, it would detract from its function as an impartial administrator. Thus, the AAA does not generally appear or participate in litigation relating to an arbitration. Therefore, the Association will not answer or appear at the Court Hearing.

The Association will, however, abide by any Order issued by the Court.

Very truly yours,

/s/ Rocco M. Scanza
Regional Vice President
RMS/ves

[Filed July 20, 1993]

SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

BRITZ, INC., HELM CONCENTRATES, INC., and **HELM TOMATOES, INC.,** Plaintiffs, v. **ALFA-LAVAL FOOD & DAIRY CO., ALFA-LAVAL CREDIT AB, THOMAS W. HINCZ, W. STANLEY PRITCHARD, THOMAS BAILEY,** and **DOE 1** through **DOE 20,** inclusive, Defendants.	CASE NO. 425766-3

ORDER CONFIRMING ARBITRATION AWARD

THIS MATTER COMES ON to be heard before the Court, the Honorable Robert Z. Mardikian, presiding, on June 14, 1993 and June 15, 1993, upon plaintiffs', Britz, Inc., Helm Concentrates, Inc., and Helm Tomatoes, Inc. (hereinafter collectively "Britz/Helm"), Petition to Vacate the Award of Arbitrator ("Admissions Motion"), Evidentiary Objections to Defendants' Declarations ("Objections"), and Responses to Petition to Confirm Final Arbitration Award ("Response"). In addition, defendants, Alfa-Laval

Food & Dairy Co. and Alfa-Laval Credit AB (hereinafter collectively "Alfa-Laval"), presented for hearing their Petition to Confirm Final Arbitration Award (as supplemented by amendment filed May 26, 1993) ("Petition to Confirm"), Motion to Dismiss Petition to Vacate ("Motion To Dismiss"), and Motion to Set a Date Certain for Evidentiary Hearing ("Motion for Evidentiary Hearing"). Frame & Matsumoto, by Ted R. Frame and Russell Matsumoto, appeared for Britz/Helm, and Wildman, Harrold, Allen & Dixon, by Craig M. White and Thomas J. Verticchio, appeared for Alfa-Laval.

The Court has reviewed all of the briefs, exhibits, and authorities submitted by the parties in support of and in opposition to the various motions on file. The Court takes judicial notice of all materials filed with the Court in this matter. In addition, the Court heard the oral arguments of counsel for the parties on June 14, 1993 and June 15, 1993.

Having heard the arguments of counsel and considered the various memoranda and exhibits filed by the parties and being fully advised in the premises, the Court issued its verbal findings and orders on June 15, 1993. The transcript setting forth the Court's oral findings and rulings in detail is incorporated herein and made a part hereof and attached as Exhibit A.

THE COURT, FOR THE REASONS STATED IN ITS VERBAL FINDINGS AND ORDERS, HEREBY FINDS AND ORDERS THAT:

(1) Alfa-Laval's Motion to Dismiss is granted, and the Petition to Vacate is dismissed with prejudice.

(2) The Admissions Motion, the Objections, and the Motion for Evidentiary Hearing are mooted.

(3) Alfa-Laval's Petition to confirm is granted, and the defenses asserted in Britz/Helm's Responses are overruled and dismissed.

(4) Pursuant to § 1287.4 of the California Code of Civil Procedure, Alfa-Laval is entitled to a final judgment in its favor and against Britz, Inc. and Helm Concentrates, Inc. in the total amount of $2,697,126.20. In addition, Alfa-Laval is entitled to accrued interest in the amount of $35,351.31 (through June 15, 1993). Interest shall accrue from the date of judgment at the statutory rate until the judgment has been satisfied. Further, Alfa-Laval is entitled to an award of costs incurred in these proceedings.

(5) Having entered final judgment in the cause, the Court dismisses with prejudice all remaining defendants.

(6) Enforcement proceedings on the judgment in favor of Alfa-Laval are stayed for a period of 30 days from the date of this Order.

DATED: July 16, 1993

ENTER:

_____

Honorable Robert Z. Mardikian

[Filed July 20, 1993]

SUPERIOR COURT OF CALIFORNIA

COUNTY OF FRESNO

* * * * *

BRITZ, INC., HELM CONCENTRATES, INC., and HELM TOMATOES, INC., Plaintiffs, v. **ALFA-LAVAL FOOD & DAIRY CO., ALFA-LAVAL CREDIT AB, THOMAS W. HINCZ, W. STANLEY PRITCHARD, THOMAS BAILEY, and DOE 1 through DOE 20,** inclusive, Defendants.	) CASE NO. 425766-3

JUDGMENT

Pursuant to the Court's Order Confirming Arbitration Award entered this date, the Court hereby orders that judgment in the principal amount of $2,697,126.20 plus interest in the sum of $35,351.31, for a Total Judgment of $2,732,477.51, plus costs in the amount of $_____, be and is hereby entered in favor of defendants, Alfa-Laval Food & Dairy Co. and Alfa-Laval Credit AB and against plaintiffs, Britz, Inc. and Helm Concentrates, Inc. Interest at the statutory rate shall accrue on the Total Judgment from date of judgment until satisfied.

DATED: July 16, 1993

ENTER:

Honorable Robert Z. Mardikian

[Filed June 6, 1995]

CERTIFIED FOR PUBLICATION

IN THE
COURT OF APPEAL OF THE
STATE OF CALIFORNIA
FIFTH APPELLATE DISTRICT

BRITZ, INC. et al.,	)	
	)	F020306
Plaintiffs and Appellants,	)	
v.	)	(Super. Ct.
	)	No.
ALFA-LAVAL FOOD & DAIRY CO. et al.,	)	425766-3)
	)	
Defendants and Respondents.	)	
	)	

MODIFICATION OF OPINION
UPON DENIAL OF PETITION FOR REHEARING
[NO CHANGE IN JUDGMENT]

THE COURT:

Respondents petitioned for rehearing on May 23, 1995, and appellants filed an answer to the petition for rehearing. Upon consideration of the petition and the answer, the petition for rehearing is hereby denied. However, the opinion filed May 8, 1995, is ordered modified in the following respects:

The second sentence of the second full paragraph on page 13 of the typewritten opinion is deleted and the following sentence is substituted therefor:

> Substantial evidence supports the trial court's finding that one of appellants had timely knowledge that Peterson's firm received business referrals from McCormick.

The second full sentence on page 29 of the typewritten opinion is deleted and the following sentence is substituted therefor:

> Pursuant to Code of Civil Procedure section 1284 (incorporating Code Civ. Proc., § 1286.6, subd. (c)), the arbitrator retained jurisdiction to correct the form of the award for 30 days after the final award was served on the parties.

The paragraph entitled "DISPOSITION" on page 32 of the typewritten opinion is deleted and the following paragraph is substituted therefor:

> The judgment is reversed and the matter is remanded to the trial court. The trial court shall conduct an evidentiary hearing on appellants' petition to vacate the arbitrator's award and respondents' petition to confirm the award. The issues at such evidentiary hearing shall be limited to the following: (1) whether the nature of the relationship between the McCormick firm and respondents, as known to the arbitrator prior to the issuance of the arbitrator's interim award, gives rise to evident partiality of the arbitrator based upon failure of the arbitrator to disclose to appellants his expert witness relationship with the McCormick firm; and (2) if so, whether the consequences of that failure to disclose are overcome by evidence presented on remand that the pertinent facts of evident partiality[11] were actually and timely revealed to or otherwise became known by appellants such that appellants have waived any right to

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[11] That is, the nature and extent of the relationship between the arbitrator and the McCormick firm.

complain about the arbitrator's failure to disclose.[12] If the court finds "evident partiality" and that such has not been overcome by evidence of waiver, then arbitration proceedings shall commence anew. If the court finds to the contrary, the judgment shall be reinstated. Appellants are awarded their costs on appeal.

This modification does not effect a change in the judgment.

/s/ Vartabedian
Vartabedian, J.

WE CONCUR:

/s/ Ardaiz
Ardaiz, P. J.

/s/ Harris
Harris, J.

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[12] As respondents correctly raise in their petition for rehearing, their efforts to present waiver evidence in the earlier superior court proceedings became moot when that court dismissed appellants' petition to vacate. We thus find it appropriate to allow, on remand, presentation of evidence of appellants' knowledge, limited to what appellants and their counsel knew during the narrow timeframe from December 2, 1991, when the McCormick firm appeared in the arbitration at a time when Peterson was currently engaged as an expert witness by McCormick, and issuance of the interim award on May 22, 1992, the timeframe during which, on the facts presented, appellants' failure to act on such knowledge may be the basis for finding waiver.